No. 1319

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of the Petition of C. K. McINTOSH and JAMES P. BROWN, as Trustees in the Bankruptcy of the Estate of A. B. Costigan, Bankrupt

Brief for Defendants

In opposition to Petition by trustees of Bankrupt Estate for Review and Revision of the Decree of the United States District Court for the Northern District of California

WM. B. HASKELL,
HENRY C. MELVIN,
Solicitors for Defendants.

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In the Matter of the Petition of C. K. McINTOSH et al., as Trustees of the Estate of A. B. Costigan, Bankrupt.

BRIEF FOR RESPONDENTS, PETALUMA SAVINGS BANK AND D. B. FAIRBANKS.

The judgment of the District Court should be sustained.

The Complaint fails to allege that there are any creditors of the bankrupt, whose claims, together with the expenses of administering the estate, would not be amply paid by the assests in the hands of the trustees.

In a recent case, decided by the Circuit Court of Appeals for the Sixth Circuit, the opinion being by Circuit Judge Lurton, the court *held*: "In a suit by a trustee in bankruptcy, to recover an unlawful preference, only so much is recoverable as is necessary for the payment of claims, and the costs and expenses of administering the estate;" and in the case of Mueller vs. Bruss (112 Wis. 406, S. C. 83 N. W. 299) the Supreme Court of Wisconsin reversed the

Rogers vs 140 Fed Syl 5.

lower court in overruling a demurrer to a complaint, which failed to allege the matters above referred to. The Mueller-Bruss case was this:

The defendant, Julius Bruss, filed a voluntary petition in bankruptcy, and was thereafter duly adjudged a voluntary bankrupt. Before he filed his petition, the bankrupt, while in debt to creditors who afterwards filed their claims in the bankruptcy proceedings, conveyed certain of his real estate to his wife, without consideration. Thereafter he conveyed certain other real estate to his daughter. Both conveyances were voluntary, and made with intent to hinder, delay and defraud his creditors; the fraudulent intent being participated in by the wife and daughter, who took possession of the property, claiming to be owners thereof. There was no allegation in the complaint *that the trustee did not have sufficient assets in his hands to satisfy the claims of the creditors.* A demurrer to the complaint was filed, on the ground that the complaint did not state facts sufficient to constitute a cause of action. The demurrer being overruled, an appeal was taken. On appeal the Supreme Court in passing on the matter used the following language:

> "A third proposition is, that the trustee cannot maintain this action unless it is shown by the complaint that he has not sufficient assets in his hands to satisfy the claims of the creditors of the debtor. No such showing is made in the complaint. For all that appears therein, there may be money and property enough in his hands to pay every claim filed against the

> debtor. The conveyances attacked were good between the parties thereto. (Ellis vs. Land Co., 108 Wisc. 313). Third parties are not allowed to impeach them unless it is necessary to do so in order that justice may be done. The trustee has no right superior to that of the creditors he represents. If we admit that the facts stated show such transfers to have been fraudulent, still no right to avoid them exists unless it appears that some one was harmed. It seems quite evident, without argument, that, unless it is made to appear that the property so conveyed is needed to pay the claims filed against the debtor, the trustee has no right to set such conveyance aside. The complaint is insufficient in this respect. It ought to show the amount of claims filed, and the value of the assets in his hands, so that the court may determine the necessity of resorting to this proceeding. Its infirmity in this respect renders it susceptible to the demurrer."

Let us pass in review the allegations of the complaint in the case now before the court, and see if any of them contain what is requisite in this behalf. Before doing so, however, we will acquaint the court with two several dates mentioned in the complaint, of some importance to be understood. The first date is, the "12th day of May, 1903." That is the day upon which it is alleged, the two certain deeds were executed by the bankrupt to the respondent, D. B. Fairbanks, conveying the lands, the subject of the preference, claimed to have been given. The other date is the "16th day of September, 1904." That is the day upon which the bankrupt filed his petition for an adjudication of bankruptcy.

The complaint:

Paragraph I, found on pages 12 and 13 of the transcript, sets forth: The borrowing of money by the bankrupt on the 12th day of May, 1903, the giving of his promissory note therefor to the cashier of the Petaluma Savings Bank, and the execution of the deeds as security therefor to D. B. Fairbanks, the cashier, conveying to him the lands in controversy. No mention of any creditors' claims.

Paragraph II, found on pages 13 and 14, alleges that the deeds to Fairbanks were in lieu of mortgages, to secure the payment of the promissory note. No mention of any creditors' claims.

Paragraph III, page 14: Alleges possession of the lands described, in the bankrupt. No reference to any creditors' claims.

Paragraph IV, page 14: Alleges the filing of the petition for an adjudication of bankruptcy, on the 16th day of September, 1904. No mention of any creditors' claims.

Paragraph V alleges that the deeds above mentioned were not recorded until after the adjudication in bankruptcy had been made. No mention of any claims of creditors.

Paragraph VI, p. 21, alleges that the defendants withheld said deeds from the records after they had reasonable cause to believe Costigan bankrupt. No mention of any claims by creditors.

Paragraph VII, page 15, alleges that the deeds are an unlawful preference.

Paragraph VIII, pages 18 and 19, alleges that the effect of the transfer of the lands mentioned will enable the defendants to obtain a greater percentage of the debt due them—than any other of the bankrupt's creditors of the same class. No mention of any creditor's claims.

Paragraphs IX and X we will take up further on.

Paragraph XI, page 23, alleges that the trustees, within 30 days after adjudication, filed a certified copy of decree of adjudication in "Fresno County, in the office of the Recorder of Deeds," the county where the land was situated. No mention of any creditors' claims.

Then follows the prayer of the complaint.

Let us now give attention to paragraphs IX (pages 22 and 23) and X (page 23) and see if either of them alleges that there are any creditors whose claims amount to more than the assets in the hands of the trustees, or, that, after payment of the same in full, there would not be enough assets to pay the expenses of administration of the bankrupt's estate.

Paragraph IX:

> "Your orators further show, that at the time said Costigan delivered said deeds to the defendants (May 12, 1903) he did not own any other real estate than that described in said deeds; that during the period named, on and between the 12th day of May, 1903, and the 16th day of September, 1904, all of the said Costigan's personal property was pledged to secure a part of his indebtedness, and that his indebted-

ness exceeded the value of the personal property so pledged in the sum of about sixty thousand dollars."

Thus far there is no mention of any creditors' claims. And, of course, under the familiar rule that a pleading, in the face of a demurrer, is to be most strongly construed against the pleader, the court will feel itself bound to assume, that *after* "the time said Costigan delivered said deeds" he acquired *other* real estate, and that when "his indebtedness exceeded the value of the personal property so pledged in the sum of about sixty thousand dollars," that it did not exceed the value of his other real estate in that amount, or in any amount, and that in reality he was not insolvent.

But to resume: The next clause of paragraph IX that we are considering is as follows:

"That the said A. B. Costigan, during the said period between May 12, 1903, and September 16th, 1904, before and after the said note to the Petaluma Savings Bank was due, represented to creditors from whom he borrowed large sums of money from time to time, that he was the owner of the real estate set forth and described in the deeds to D. B. Fairbanks hereinbefore more fully described, but failed to, and did not notify said creditors that he had conveyed said property by deed to the said D. B. Fairbanks; that by reason of said representations, and by reason of the failure of the defendants to have the said deeds recorded and their failure to disclose the existence of such deeds, the said creditors were misled and deceived and gave credit, and made large loans of money to the said A. B. Costigan; and your

orators allege that the failure to so record said deeds by the defendants gave a false credit to said Costigan, and operated as a fraud on his other creditors, who are still unpaid."

The above completes the allegations of paragraph IX. There is no allegation that there are any creditors of the bankrupt whose claims, together with the expenses of administering the estate, would not be amply paid by the assets in the hands of the trustees. This entire paragraph bears no fruit by way of useful allegation. The part which alleges that Costigan "before and after the note to the Petaluma Savings Bank was due, represented to creditors from whom he borrowed large sums of money from time to time, that he was the owner of the real estate set forth and described in the deeds to Fairbanks," fails to allege that he did not pay said creditors the money "borrowed from time to time," nor that the amount thereof, as we have elsewhere said, was not more than covered by the assets in the hands of the trustees, if such creditors still held claims against Costigan when he became bankrupt, and if they were "still unpaid," how much their claims amount to and what relation that amount bears to the assets on hand.

This brings us to paragraph X, page 23. In this paragraph the pleader sets forth in detail the property owned and possessed by the bankrupt on the day of the adjudication, but makes no attempt at showing that the claims of the creditors exceed it in value. It concludes with the following words, "that

if the said bank is permitted to take said property to satisfy its claim of nine thousand dollars, it will result in great loss and injury to the other creditors of the said Costigan."

How is the court to know from the above, that the property conveyed to defendant Fairbanks did not leave sufficient assets in the hands of the trustees to satisfy the claims of the creditors. Or, if it did not, that the surplus in value of the land beyond any claims of Fairbanks upon it, when added to the assets in hand was not ample to pay the claims of the creditors?

There is nothing in either of these paragraphs, IX or X, which states that the assets in the hands of the trustees is not more than sufficient to pay all the creditors of the bankrupt.

There is no allegation in the complaint that the claims against Costigan, bankrupt, and the expenses of administering his estate amount to more than the value of his "seat in the Merchants' Exchange" "and the ten shares of Pacific Motor Car Company;" or if these sums exceed those values, that they will not be more than paid by the thousand dollars excess value of the real estate mortgages to the bank, over and above the claims of the bank upon it?

There being no allegations anywhere in the complaint that the bank lays claim to anything more than the amount of its claim of nine thousand dollars, what is there to prevent the trustees from selling this real estate in a summary proceeding, if the sur-

plus in value is necessary for the payment of claims, paying the bank the amount of its mortgage, and devoting the surplus to the payment of the creditors' claims, if there are any, and to the expenses of administering the estate according to law?

What right have the trustees to invoke the jurisdiction of the court in a plenary suit, to set aside these transfers, without exhibiting a reason, based on the conditions and exigencies of the estate, as a warrant for so doing? Not having shown that there are any claims of creditors to be paid, what will they do with the proceeds of this "preference?" Will they give it back to Costigan?

The concluding paragraph of subdivision X of the complaint, in these words:

"that if the said defendant bank is permitted to take said property to satisfy its claim of nine thousand dollars, it will result in great loss and injury to the other creditors of the said Costigan," must have something in the complaint somewhere to give it support. There must be "loss" or "injury" to the creditors from a failure of assests, affirmatively alleged or the pleading is insufficient.

II.

The failure to record the deeds until after the adjudication, in the absence of an allegation that they were withheld from record by agreement between the parties for the fraudulent purpose of giving to the bankrupt a false credit;

or that the grantee actively concealed the fact that such deeds were made with fraudulent intent to deceive and defraud the creditors of the grantor, is not sufficient to make such deeds an unlawful preference.

It is provided by Statute in California that "An unrecorded instrument is valid between the parties thereto and those who have notice thereof." (Civil Code Sec. 1217.)

What an "instrument" is, as used in the Codes, the Supreme Court of California has stated to be as follows:

"The word 'instrument,' as used in the Codes, invariably means some written paper or instrument signed and delivered by one person to another, transferring the title to or giving a lien on property, or giving a right to debt or duty."

Hoag vs. Howard, 55 Cal. 564.

There can be no question that the deeds from Costigan to Fairbanks are "instruments" within the meaning of the above Section of the Civil Code. There is another Section of the Civil Code that bears somewhat on the matters here. It is Section 1107, the provisions of which are as follows:

"Every grant of an estate in real property is conclusive against the grantor, also against every one subsequently claiming under him, except a purchaser or incumbrancer who, in good faith and for a valuable consideration, acquires a title or lien by an instrument that is first duly recorded."

"The lien of an unrecorded mortgage," says the Supreme Court in the case of Bank of Ukiah vs. Petaluma Savings Bank (100 Cal. 590), "given to secure a loan, is created by the mere execution and delivery of the mortgage, and takes precedence over an attachmnt or judgment lien obtained after its execution."

So that we have, in the case before the Court, a deed constituting a mortgage, executed on the 12th day of May, 1903, to secure a loan, made on that day, but not recorded until a few days after the adjudication of bankruptcy. Is such a deed or mortgage valid under the bankruptcy Statute? We contend that it is, unless it has been shown to have been purposely withheld from the records by agreement between the parties, for the purpose of defeating the provisions of the bankruptcy law, or that other persons were thereby induced to extend credit to the grantor or mortgagor or forego their legal rights.

In a case recently decided by the District Court of the United States for the Northern District of New York (In re Hunt 139 Fed. 283), the facts were as follows:

The bankrupt gave a mortgage in June, 1903, on all his real estate, to the Delaware National Bank. A year after that, on the 10th of June, 1904, the mortgage was recorded. A week after the recording he was on his own petition adjudged a bankrupt.

The existence of the mortgage from the time of its execution to its recording, a period of a little over a

year, was known to the Mortgagor (bankrupt) and the bank and its officers only.

When the mortgage was given the president of the bank, who conducted the business about the mortgage, asked the Mortgagor Hunt "if he would not give him a mortgage to secure what he owed the bank." In reply he agreed to do so, requesting that it be not recorded, asking if it was necessary to record it, also stating that he owed no one else, and that to record the mortgage might or would "hurt his credit in New York." The president of the bank said in reply, he "would not be in a hurry about recording it." The president very soon thereafter consulted one of the directors of the bank as to this necessity for recording, and was advised by him (who seemed also to be the legal counsel of the bank) that it was not necessary, in view of the mortgagor's statement that his entire indebtedness was represented by obligations in the bank.

In fact, at the time the mortgage was given, the mortgagor owed at least $25,000 in that vicinity and elsewhere, or about $20,000 more than he owed the bank. This had been his indebtedness to various parties for several years. The personal estate of the mortgagor was worth only about $3000. During the period of the existence of the mortgage, and while it remained unrecorded, extensive credit was given and extended to the mortgagor. And on two occasions the president of the bank stated in substance, to inquirers to whom the mortgagor owed

money, that he owned his real estate clear.

The referee sold the mortgaged property and deposited the proceeds of sale to await the determination of the court as to the validity of the mortgage as a lien in preference to the claim or right of the trustee.

District Judge Ray, writing the opinion, first quoted Section 60 b of the Bankruptcy Act as follows:

> "If a bankrupt shall have given a preference, and the person receiving it or the person to be benefited thereby, or his agent acting therein, shall have had reasonable cause to believe that it was intended thereby to give a preference, it shall be voidable by the trustee and he may recover the property or its value from such person."

He then *held*: "The bank and its agent, the president, intended to secure and secured this mortgage for the purpose of obtaining a preference," within the meaning of the statute. "But," says the learned judge, "to constitute a *voidable* preference within the meaning of the bankruptcy act, something more is necessary. Subdivision "a" of the same section (Section 60) says, "A person shall be deemed to have given a preference, if, being insolvent (the mortgagor was insolvent) "he has within four months before the filing of the petition . . . made a transfer of any of his property" (this he has done, for a mortgage is a transfer) "and the effect of the enforcement of such transfer" (mortgage) "will be to enable any one of his creditors to

obtain a greater percentage of his debt than any other of such creditors of the same class." (This it will do, for there were other creditors of the same class, who will receive nothing if this mortgage prevails.) Where the preference consists in a transfer" (mortgage) "such period of four months shall not expire until four months after the date of the recording or registering is required." "This last sentence," says the judge, "was added by the amendment of February 5, 1903."

This last sentence made quite a change in the bankruptcy act, with reference to the period of time over which the investigation of a bankrupt's transactions should take place. And in order that his views might be made plain he gave the following history of the amendment.

"As introduced in the House of Representatives by the author of the amendment, as it was reported from the Judiciary Committee of the House, the words 'or permitted, or if not, from the date when the beneficiary takes notorious, exclusive or continuous possession of the property transferred,' followed the word 'required,' and ended the sentence. Had the section become a law in this form, the ending of the amendment would have been, 'If, by law, such recording or registering is required or permitted.' In this regard it followed subdivision b, Section 3 of the act. The Senate struck out the words 'or permitted,' etc., above quoted. Did it regard these words as surpersage? Were they surpersage?

This court thinks not. The words 'if by law such recording on registering is required' must mean the same as they would if the words 'to make the transfer valid as against the general creditors of the person executing it' were added after the word required.' "

After showing the meaning of the last sentence of Section 60 a, he went on to say concerning the case he was deciding:

"In New York the registering or recording of a mortgage on real estate is not required in order to give it validity as against the mortgagor, or general, or even judgment creditors, consequently recording is not required to give it validity as against the trustee in bankruptcy. The word 'required' does not mean the same as 'permitted,' or the same as the words 'required in any case, or for any purpose.' "

"In some States a real estate mortgage must be recorded or registered to be good as against even general creditors. The laws of New York require the recording of such a mortgage as against purchasers and mortgagers in good faith and for value only."

He then quotes the following from the Statutes of New York. (Laws of 1896, p 607, c 547.)

> "Sec. 241. Recording of conveyances. A conveyance of real property . . . . may be recorded. . . Every such conveyance not so recorded is void as against any subsequent purchaser in good faith and for a valuable consideration . . . . whose conveyance is first duly recorded."

A reference is then made to Collier on Bankruptcy 5th Edition, p 453, for some strictures on the failure to adopt the "Ray bill" containing the matter stricken from the amendment by the Senate above reefrred to, and some concurring remarks by Judge Ray, and concludes this branch of the opinion by saying, "The date of the beginning of the four-months' period referred to ought to be the date of the recording or filing the instrument or of taking open possession of the property. However, courts must administer the law as they find it."

"Within the meaning of the act," says the judge at page 287 of the report, "a preference (by mortgage of real estate), to be avoided by the trustee, must have been given by the (now) bankrupt under the following conditions: (1) The debtor must have been insolvent. (2) The effect of the enforcement of the preference (mortgage in this case) must be to enable any one of the creditors to obtain a greater percentage of his debt than any other of such creditors of the same class. (3) The person receiving such preference, or his agent acting in receiving it, *must have had reasonable cause to believe that it* was intended thereby (the giving and receiving of the instrument) to give a preference; is, in making such transfer by giving the instrument, to enable the creditor receiving it to obtain a greater percentage of his debt than that received by any other of such creditors of the same class. (4) *In the State of New York* such instrument, if a mortgage of real

estate, must have been *executed and delivered within four months* immediately preceding the filing of the petition in bankruptcy. It is proper to say, that in New York the purpose of recording real estate mortgages is not, and has not been, to give notice to or protect the general creditors, or even judgment creditors of the mortgagor. As to judgment creditors, even unrecorded mortgages on real estate are valid."

Judge Ray then (p 287, near bottom) comments on the difference between the rule in New York as to judgment creditors, and that which obtains in Georgia. Saying that in the latter State the law requires a mortgage of real estate to be recorded. Evidently answering some position taken by counsel for the trustee in reliance upon a Georgia case.

Next, Judge Ray, at the top of page 288, says "a trustee in bankruptcy is not a purchaser in good faith, nor does he occupy the position of such a purchaser. He takes the property of the bankrupt in cases not affected by fraud in the same plight and condition the bankrupt held it as of the date of the adjudication, and subject to all equities impressed on it in the hands of the bankrupt, except in cases where there has been some conveyance or incumbrance void as against the trustee, made so by some positive enactment of the bankrupt law."

Citing in support, in re Garcewich 115, Fed 87-89, 53 C. C. A. 510, Thompson vs. Fairbanks 196 U. S. 526 and other authorities.

The judge then takes up a number of cases in which care was not taken to distinguish between those cases where a lien is actually created or given by an agreement in writing, and those where a lien is agreed to be given or created in the future, showing that much confusion has resulted, and then passes on pages 290 and 291 to a consideration of the facts of the case before him. And we invite the particular attention of the court to those facts found by the judge actually to exist in that case, and contrast them with the facts of this case as disclosed by the complaint.

In the first place Judge Ray says:

"There can be no doubt that there was an agreement between Hunt, the mortgagor and Honeywell, the president of the bank, at the time the mortgage was given, and as a part of the transaction, that the bank would not put the mortgage on record at that time."

In the case at bar there is not a word said in the complaint that anything was said, agreed or understood between the Petaluma Savings Bank or the Fairbanks acting for it, and the bankrupt Costigan about recording or not recording the deeds. Indeed, the complaint does not allege that at the time the deeds, constituting the mortgage, were executed, that Costigan, the bankrupt, was insolvent, or had a single creditor outside of the one created by the making of the loan, that is to say the Petaluma Bank, or that the Petaluma Bank, the Fairbanks or

any one at all suspected even that Costigan was bankrupt, and there is no possible way of telling even now, so far as the complaint is concerned whether he was insolvent or not insolvent, down to the very date almost of the filing of the petition, nearly a year and a half later.

To bring Costigan within the purview of the Statute with reference to preferences, yes, to constitute a preference at all, there is a prerequisite absolutely indispensable to exist—that is to say, a man must be *insolvent* to constitute a preference—insolvency is a *sine qua non.*

The definition of a preference is found in Section 60 a of the bankrupt act. What are its initial words? "A person shall be deemed to have given a preference if *being insolvent,* he has," etc. Search the complaint industriously, take its allegations, few indeed, and its innuendos and implications there are many, and put them all together in their strongest array and they will not bring forth the allegation that Costigan was insolvent on the twelfth day of May, 1903, the day of the transfer, or even had a creditor in the world at that time.

How different from the New York case. In that case the bank had been dealing with Hunt for years before the unrecorded mortgage was executed, and, as a fact, he was hopelessly insolvent, and, "being insolvent, made the transfer."

The judge proceeded with the facts:

"There is no doubt that there was also an under-

standing between Hunt and Honeywell at some time that the mortgage must have been executed and delivered over four months prior to bankruptcy proceedings in order to be good as against general creditors." This, of course, looks bad on its face, and approaches the domain of fraud, and there is an attempt in the case at bar to allege the existence of a state of facts which would bring this case into the same category. The language is as follows:

"Your orators allege that on this 12th day of November, 1903, when the note of the said A. B. Costigan became due and payable, ... the said defendants did not make known to the creditors," etc. (Tr p 21, par. VI.)

Judge Ray, commenting on the above state of facts in the New York case, went on in the next sentence to say, "But the evidence would tend strongly to show that this understanding was arrived at about May, 1904, not in June, 1903." It being the law of New York, that the mortgage or preference was complete the day that it was delivered—on the day upon which the transaction took place, and not on a subsequent day. So that, in the opinion of the judge, there was a period of time of considerable duration which elapsed after the relative rights between the mortgagor and mortgagee had become settled before any understanding took place with reference to the four months' period—that is the period of four months had already elapsed. So here the date of the commencement of inactivity

with reference to recording did not have its beginning until six months after the execution of the mortgage and the delivery by the bank to Costigan of nine thousand dollars.

The rest of the facts of the New York case, taken from the words of Judge Ray, and found, commencing at about the middle of the last paragraph on page 290 of the report, may be summarized as follows:

In April or May, 1904, Honeywell (president of the bank), when asked as to the financial responsibility of Hunt (the bankrupt), said in substance, they (meaning the bank) regarded him (Hunt) as solvent.

That he had in real estate, with nothing against it, more than the amount of the bank's indebtedness, and his stock of goods and accounts would more than offset his other indebtedness. Honeywell did not know even approximately the indebtedness of Hunt. Shortly before filing his petition in bankruptcy, Hunt made incorrect and untruthful statements regarding his indebtedness to some of his numerous creditors.

Honeywell, along in the spring of 1904, but more than six months after the execution and delivery of the mortgage, failed to disclose that the bank held the mortgage when inquiry was made as to the standing and financial responsibility of Hunt.

Right at this point Judge Ray pointed out in a few words a significant matter with reference to the "concealment of the fact" that the mortgage was in

existence, which applies with equal force to the allegations of the complaint in the case at bar, to which we will in a moment direct the attention of the court. Commencing after the semi-colon on the fourth line from the top of page 291, Judge Ray says: "but it is not shown that Honeywell had authority to make such concealment." The law being, of course, that a corporation must act through its duly authorized agent and can only be bound by an agent having such authority—and that in order to bind the bank the real party with whom the transaction of the execution of the mortgage took place, it must be shown that the person assuming to act for it had authority to so act. In the case at bar we have the allegation in the complaint (Tr p 12) "A. B. Costigan, now a bankrupt, borrowed from the Savings Bank of Petaluma, a corporation doing business at the town of Petaluma, in said State, the sum of nine thousand dollars." In paragraph VI, page 21, we find the allegation that H. T. Fairbanks, the president of the bank, "had knowledge" (six months after the mortgage was executed and the money lent) "that Costigan was engaged in a hazardous business—was speculating in margins—that the real estate had been conveyed to him by his father, J. M. Costigan, for the purpose of securing credit, and was on friendly and confidential terms with Costigan senior and junior, and had reasonable cause to believe that Costigan junior was insolvent. Yet there is not an allegation or a hint that the bank

knew any of these things, or that it was on account of any such knowledge that the bank, the real defendant here, withheld the deeds from record. In the absence of an allegation of the complaint connecting the bank with the matters attempted to be charged in paragraph VI, what is it all worth any way.

In concluding the opinion, Judge Ray says of the evidence in the New York case, just as we say of the allegations of the complaint here, "But it is not shown that he actively concealed the existence of the mortgage, or that Honeywell's acts and declarations whatever they were, influenced any person to give or extend credit to Hunt. In short, it is not made to appear that the nonfiling of the mortgage either induced any person to give credit to Hunt or forbear suit or bankruptcy proceedings. If the evidence established that Honeywell, president of the bank, mortgagee, kept secret and withheld the mortgage from record for the purpose of allowing the four months to run so as to defeat the povisions of the bankruptcy act relating to preferences and intended so to do when he took it, this court would hold that such acts were in fraud of the act, and rendered the mortgage void. (Blannerhassett vs. Sherman, 105 U. S. 100; Clay vs. Exchange Bank of Macon, 121 Fed 630; Curtis, Receiver vs. Lewis, 74 Conn. 367; Hildreth vs. Sands, 2 Johns Ch. 35.) But while the court may have its suspicions that such was the fact, it is not therefore at liberty to so find or hold, even if those suspicions are justified by and grow out of the

evidence. Fraud must be proved. It may be inferred from facts established by competent proof, but the inference of fraud cannot legally be drawn and is not justifiable when the inference of innocence is just as consistent with the facts. I cannot find from this evidence that the failure to record the mortgage was accompanied by such acts on the part of the mortgager or of its agents that a fictitious credit was given to Hunt, now the bankrupt, or that the acts of the defendant induced any creditor to forego any right. The defendant is not estopped from asserting the mortgage."

We have drawn largely upon the foregoing opinion, for two reasons. First, it is written, and the case decided from the point of view of the law of a State almost identical with our own; one from whose legislation and judicial decision greater and deeper draughts have been made by California, than from any other country, save England alone; and, second, the facts bear many features that may be recognized in the countenance of our case, and the reasoning of the learned judge more strikingly sets forth and the exposition of the legislative changes wrought in the bankruptcy act by the Amendment of February 5, 1903, are better illustrated than they have been in any reported case since the amendment, that we have been able to find.

In his opinion sustaining the demurrer, Judge De Haven concludes with the words, "It is not sufficient to simply allege probative facts from which it may

be argued that there was such agreement or active concealment," referring to the rule stated in an earlier part of the opinion, in harmony with the dictum of Judge Ray, above quoted. An inspection of the allegations of the complaint found in paragraph VI on page 21, and paragraphs IX and X on pages 22 and 23 will show how well founded the concluding remarks of Judge De Haven are.

Take, for instance, paragraph VI and follow it to the last period (punctuation mark) on page 21: in its entire twenty-one lines, the only statement of a fact is "that the said several deeds were not filed for recording with the recorder of the County of Fresno, State of California, by the said defendants." All that precedes this statement is mere conjecture. It does not even allege directly that the promissory note fell due on the "12th day of November, 1903." Instead, it says, "Your orators allege that on the 12th day of November, 1903, *when* the said note of the said A. B. Costigan became due and payable, and the said A. B. Costigan defaulted and failed to pay the same, the said H. T. Fairbanks, president of the said defendant bank, *who* had knowledge that the said A. B. Costigan was engaged in a hazardous business . . . . . *yet* the said defendants," etc., etc. None of these clauses rises above the dignity of probative facts, from which an inference may be drawn, or an argument based that the defendants by some indirection or other, did something that they ought not to have done, or omitted

something that they ought to have done. It is not right to place a defendant, a respectable institution, on trial upon arguments, innuendos and inferences, when it is so easy to state facts as facts, if they have any foundation in truth.

If the transfer by Costigan to the bank in May, 1903, is to form the basis of a charge of voidable preference the very first thing that the law requires to make it such is that Costigan was *insolvent* when it was made. The language of Section 60 a is, "A person shall be deemed to have given a preference if *being insolvent,* he has," etc. Now, instead of saying that "the said Costigan, at the time he made and delivered said deeds was insolvent," the pleader chose the inferential method by the followng statements of probatve facts: "Your orators further show, that at the time said Costigan made and delivered said deeds to the defendants, he did not own any other real estate than that described in said deeds." Then follows the statement that "between the 12th day of May, 1903 and the 16th day of September, 1904 (the dates respectively of the transfer and the filing of the petition) all of the said Costigan's personal property was pledged to secure a part of his indebtedness, and that his indebtedness exceeded the value of the personal property so pledged in the sum of about sixty thousand dollars." These statements were evidently made for the purpose of basing an argument upon them that Costigan was insolvent on the 12th day of May, 1903. But see how

wide of the mark even that inference or argument must be. For instance, it might be true that he owned no other real estate on the 12th day of May, 1903, yet at the time "all of the said Costigan's personal property was pledged to secure a part of his indebtedness," he might have had other real estate to cover much more than the excess over sixty thousand dollars for which the personal property was pledged, because the date of the ownership of the real estate was placed on a single day (May 12th, 1903), while the pledging of the personal property to secure a part of the indebtedness is given the wide range extending some time "between the said 12th day of May, 1903, and the 16th day of September, 1904.

There are two cases from the State of Ohio, "In re Chadwick 140 Fed. 674 and National Valve Company 140 Fed. 679, in harmony with the case from New York. (In re Hunt supra.) The former was decided in the United States District Court for the Eastern District of Ohio and the latter the Northern Disrict. The Chadwick case arose under the amendment of February 5, 1903, to Section 60 a, and the question presented and decided was similar to that of In re Hunt, and decided the same way, except that the question of active concealment and agreemnt not to record were eliminated. The reasoning of Judge Tyler on page 677 is particularly applicable to this case.

Another case, of somewhat higher authority,

notably from the Circuit Court of Appeals, for the Eighth Circuit, decided on the 17th of November of last year, but not finding its way into the reports until the month of May of this year, is First Nat. Bank, etc. vs. Connett, 142 Fed. 33. In that case the Court by Hook, Circuit Judge, adds another voice to the proposition announced in the foregoing cases. The decision there was written from the point of view of the laws of the State of Missouri. The question arose on the voidability of a preference based on a chattel mortgage, executed before the four months' period, but not recorded until after that period, the Court held that, inasmuch as a chattel mortgage under the Missouri law comes into existence as a mortgage as to general creditors when it is recorded, it likewise comes into existence at the same time, as to the trustee. And in this sense the laws of Missouri "required" that it be recorded. A mortgage of realty in California, as to the general creditors, comes into existence on delivery, not on recording.

The case of In re Montague 143 Fed. 428, arose in the District Court of the United States for the Eastern District of Virginia, involved a question similar to the above case from Missouri, to wit, the meaning of the words "if by law such recording or registering is required," found in Section 60 a (concluding words), and was similarly decided.

We believe that the foregoing cases are ample to show that in a State where, by its own laws, a mort-

gage or other transfer of real or personal property first comes into existence as to general creditors, when it is made, or executed between the parties to it, that its recording is not required within the meaning of Section 60 a of the bankruptcy act. And that whether its being recorded is or is not "required," is a matter of the law of the State where the transfer takes place.

On examination it will be found that the cases cited by Counsel for the petitioner on this appeal, cases like Chesapeake Shoe Co. vs. Seldner 122 Fed. 593 (petitioners brief p 29), (a Virginia case); Neslin vs. Wells 104 U. S. 428, petitioner's brief p 12 (a Utah case), and all save In re Lewkins 138 Fed. 188, Pet brief, p 27 (a Pennsylvania case), are cases in which something more than delivery is essential to constitute a valid lien as between a person giving a preference and the creditor. For instance, the Virginia case is one in which the Court held the recording *"required"* under the State law. It was a case of a verbal contract of sale, the laws of Virginia "required" a written memorandum of such contract to be *docketed.* In the Utah case the Statutes of that State (Territorial Laws, June 18, 1855, Laws of Utah, 1851-1870, page 93), made the validity of a transfer to depend on *recording;* hence, recording was "required."

To this list also belongs the case of English vs. Ross 140 Fed. 630, cited by Counsel at page 13 of brief, a case from Pennsylvania. In the English

Ross case the U. S. District Court for the Middle District of Pennsylvania held that a deed given for security, executed before the four months' period, without possession taken at the time of the giving of the deed, is to be judged on the question of preference by the date when it is put on record. There was something more than delivery required by the laws of Pennsylvania to complete the transaction as between the grantee and general creditors.

The case of In re Lukens 138 Fed. 188 is confidently relied on by Counsel for petitioners. It is a case which at first blush seems to be at variance with all of the cases decided by the District Courts and Circuit Courts of Appeals throughout the United States, since the adoption of the amendment of February 5, 1903. But a careful reading will show that Judge McPherson, in his opinion, had his attention directed entirely to Section 67 a of the bankruptcy act instead of Section 60 a and 60 b, which we have under consideration. A reading will show that the learned judge never once referred to Section 60 a or b, which deal with the question of preferences. The judge treated the case from the point of view entirely of liens by record. At page 191 he says, "It" (Section 67 a) "forbids the holder of an instrument, who might have had a lien if he had recorded it before the bankruptcy, to acquire such a lien by recording it afterwards." The trouble with this is, that it would not apply in California, for under the California law, as we have already pointed

out, "the holder of the instrument, acquired his lien, as soon as he obtained the instrument, and without record it was "a valid lien as against the claims of creditors of the bankrupt"—yes, even against judgment creditors of the bankrupt—which is further than many of the States have permitted the relations of debtor and creditor to go.

Judge McPherson was very much incensed apparently at the reasons given by his referee in bankruptcy, for holding that a mortgage in Pennsylvania conveyed an estate in the land and left nothing but an "equity of redemption" in the mortgagor, and in his endeavors to set the case right on that question he devoted no time at all to the consideration of Section 60 a.

At the bottom of page 191, the learned judge says, "I do not see why a delinquent mortgage creditor who has slept upon his rights should be regarded with favor and should have the benefit of any subtleby of construction." When Judge McPherson wrote that he was evidently not quite over his indignation at the decision of his referee. At any rate he was not thinking of mortgagees in California. Here, a mortgagee who puts his mortgage in his desk instead of placing it on record, is not regarded as a "delinquent who has slept on his rights." We have more regard for institutions that lend money in California than they seem to have in Pennsylvania. And who is hurt by it? Every man in California that knows anything knows that it is possible for a

man to transfer or incumber his property by an unrecorded instrument and that such unrecorded instrument is valid against every one but a *bona fide* purchaser for value whose conveyance is first duly recorded, and judgment creditors in judgments affecting the title. He gives credit to no man merely because he has real estate standing of record in his name, for he knows that it may all be conveyed away and the record disclose nothing. At page 12 of his very admirable brief, second paragraph from the top, counsel says:

"As I shall presently demonstrate, such recording is *required by law.* It can not alter or affect the provisions of the Section" (60 a) "whether its recordation is limited to certain objects and for certain purposes by State law. If its recordation is required *for any purpose,* it must be said that 'it is required by law 'and for the purposes of a *preference* or its legality under Section 67 a and d, these sections make no exceptions." Counsel begins his demonstration on page 16, quotes becomingly from Chief Justice Marshall on page 18, and ends on this subject, we cannot tell exactly where, but gather from what he has to say on page 16 and the two or three following pages that he has failed to grasp the meaning of the phrase *"if record thereof was necessary to impart notice,"* found in Section 67 d. Counsel proceeds on the theory that the words "record thereof" were not exclusive of every other kind of notice, as used in the phrase. A little re-

flection will disclose the fallacy of such a position. The words "if record thereof was necessary to impart notice" may be illustrated by the following: In some States record of a transfer is absolutely necessary to impart notice—and the law will not be satisfied with any other kind of notice. In such a case the words "if record thereof was necessary to impart notice" come into play. Take, for instance, the case of a chattel mortgage executed in Missouri the law of that State provides that "no mortgage of personal property shall be valid against any other person than the parties thereto, unless *possession* of the mortgaged property be delivered to and retained by the mortgagee, or unless the mortgage be *recorded* in the county in which the mortgagor resides." Here it could not be said that "recording is required to impart notice," because, notice may be given by taking possession of the mortgaged chattels, and the words "recording is required" is not exclusive. But take the case of a Chattel Mortgage executed under the laws of California.

Section 2957 of the Civil Code provides:

"A mortgage of personal property is void as against creditors of the mortgagor . . . . unless . . . . 2. It is acknowledged or proved, certified *and* recorded, in like manner as grants of real property." In such a case there is no alternative. No *change of possession*, no *actual notice*, no *anything*, but only *"recording."* Without it, the chattel mortgage is void as to general creditors and

so of course as against the trustee, for he represents the general creditors. Now that is a case which comes directly within the words *"record thereof necessary to impart notice."* No other kind of noice will impart anything but only "record thereof." Now there are many States of the Union whose statutes as to Chattel Mortgages are similar to those of California, and the lawyer who drew the provision—the phrase above quoted, from Section 67 d—knew just what he was about. He knew better than the learned Counsel for petitioners has expressed himself in his industrious brief, that to leave this clause out of the bankruptcy statute, would allow a Chattel Mortgage in some States to escape under the bankrupt act, where the State Statute held him. This clause estopped the Chattel Mortgagee from saying to the creditors, "You had actual notice of my mortgage more than four months before the petition in bankruptcy was filed."

Now, however, in a case like the California Statute presents, all the actual notice in Christendom will not avail. Actual notice does not under that law impart notice of a Chattel Mortgage. No kind of notice imparts it, but a Chattel Mortgage that is recorded. Hence, "recording is necessary to impart notice."

For some hints on this subject I would respectfully refer the court to the remarks of Circuit Judge Baker, sitting in the Circuit Court of Appeals for the 7th Circuit, in the case of Security

Waerhousing Co. vs. Hand (143 Fed. 32) at pages 42 and 43 of the report.

In conclusion, let us say that we do not, and have not anywhere in this case brought in question the jurisdiction of the court to exercise either plenary or summary jurisdiction. Therefore, the first seven or eight pages of Counsel for petitioners brief are wasted.

Opposite Counsels object of course is apparent. He feels that it is necessary to show error at any cost, and if he cannot show it as to a plenary suit, he will do it as to a summary proceeding. But a suit of this character is not a summary proceeding. We are here by invitation of the trustees asserting our lien over specific property, according to their own allegations, and so long as the petitioners show themselves unwilling to treat our mortgage as a valid one, there is no room for the exercise of the summary jurisdiction of the court.

A suit brought merely for the purpose of having our deeds declared to be mortgages with nothing more asked, would not be entertained for a moment. It would not state facts sufficient to constitute a cause of action. Strip this case of all that Counsel has prayed for on the ground of a voidable preference, and what is there left? With those allegations it does not state a cause of action. Nothing from nothing leaves something is the inevitable result of Counsels' logic. We have made no attempt at following Counsel through the mazes and labyrinths of

decision he has so laboriously gone over, nor do we deem it important to do so. The suggestion that the recording of our mortgage, subsequent to the adjudication in bankruptcy, gave the trustees some rights in the title to the property superior to our own, is without merit. We have elsewhere shown that a prior unrecorded mortgage takes precedence over a judgment. And it would indeed be a singular state of facts if it were the law that a lien that could not be acquired by a creditor before adjudication could be acquired afterwards.

We respectfully submit the foregoing as furnishing ample cause for the sustaining of the decision of Judge De Haven.

July 7, 1906.

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